KSH saw its share price rise on a tear in 2017 before falling back to nearly where it started. Is it now undervalued?

KSH Holdings (SGX:ER0) is a property developer and contractor that was listed on the SGX mainboard in 2007. It has three business arms: construction, property development and property investments. KSH is one of just 94 A1-graded contractors with the ability to tender for public sector construction projects of unlimited value in Singapore.{loadposition advert1}

In Apr 2017, KSH's share price began a dramatic surge from 44c and peaked at 91c in Oct 2017, before giving up most of those gains within a year. There is no shortage of articles that had tracked (and fueled) the euphoric rise in KSH's share price, but the pull-back to 53c since then has presented an interesting investment case.

Positive Factors

Some propositions for investing in KSH Holdings are as follows:

1. Strong balance sheet and dividend yield

As of 38 Sep 2018, KSH has a cash equivalent position of S$89.7m and borrowings of SS$141.7m, which puts net gearing at 24%, a very strong balance sheet position for property/construction company. Furthermore, at a share price of 53c, KSH has a dividend yield of 4.2%, significantly higher and more consistent than the SGX property/construction sector average of about 3%. Furthermore, with NAV per share of 59c, KSH is trading at a 10% discount to NAV.

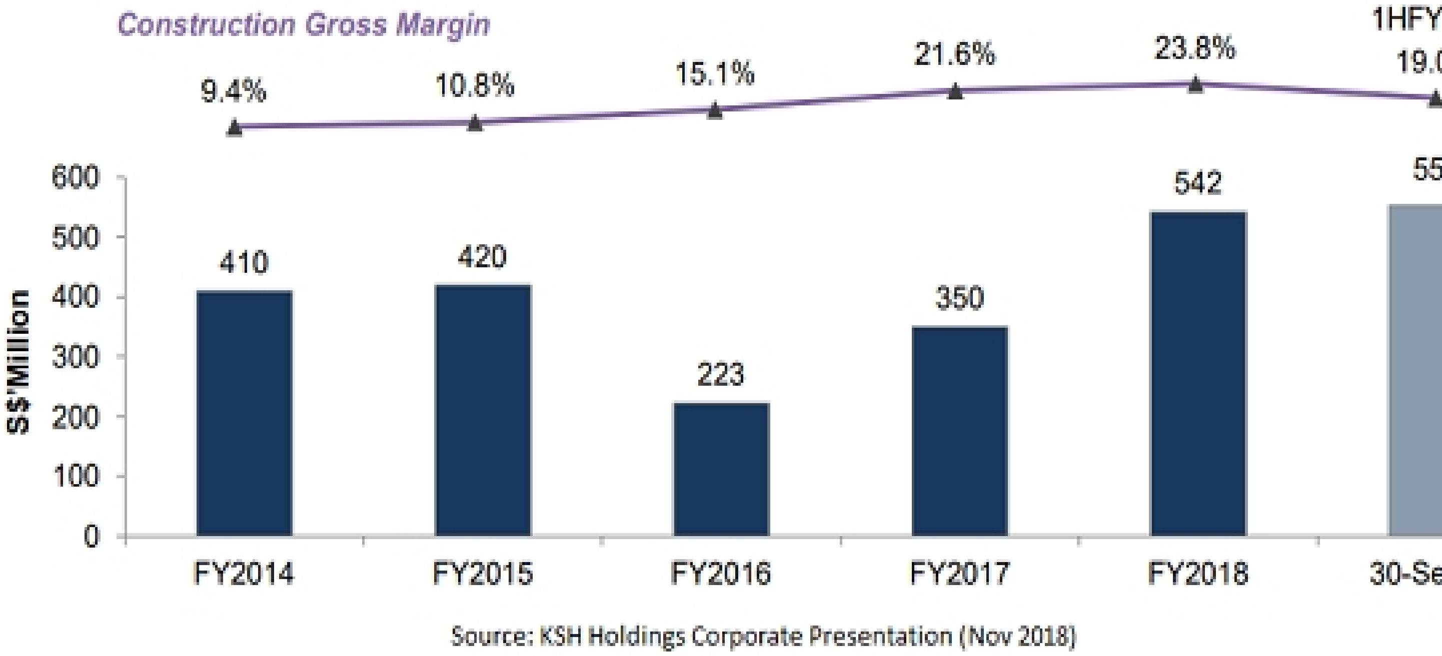
KSH thus compares favorably with some of its Singapore-listed “contractor-developer” peers from an overall earnings and debt-leverage perspective. While Lian Beng may appear to have better valuation (vis-à-vis KSH), the former’s share price has taken a beating recently, which may be due to its paying-over-the-odds for Sembawang Shopping Centre as well as poor market reception to its strategic priorities.

Stock	Share Price	P/E	Dividend Yield	P/NAV	Market Cap	Debt/
KSH	S$0.53	10.6	4.10%	0.91	S$305m	[illegible]
United Engineers	S$2.60	30.1	1.50%	0.85	***S$1,607m***	[illegible]
Koh Bros	S$0.245	6.2	2.50%	0.35	S$101m	[illegible]
Hiap Hoe	S$0.87	5.7	1.70%	0.54	S$409m	[illegible]
Chip Eng Seng	S$0.76	10.5	***5.30%***	0.61	S$476m	[illegible]
Lian Beng	S$0.475	***4.8***	4.70%	***0.35***	S$237m	[illegible]

Source: SGX (as of 4 Dec 2018)

2. Construction order-book and development pipeline.

KSH has a substantial construction order book of nearly S$533m at the end of Sep 2018, which is nearly 4 years’ worth of revenue in FY2018 (excluding share of associates’ revenue) and provides earnings visibility well into 2022. Furthermore, KSH’s orderbook is unlikely to remain stagnant, as there is a large tender pipeline contributed by upcoming redevelopment of en-bloc sale sites closed in the early half of 2018. The below chart shows the trend for KSH's construction orderbook and it is clear that KSH's order book is now the highest in at least 4 years, with margins at the healthy ~20% range, which should drive earnings growth going forward.



On the development front, KSH also has some earnings certainty, given its large pool of profits of development units sold but not yet unrecognized. Indeed, KSH's 2018 Q2 results announcement states that its development properties launched in the preceding three months (between Jun to Sep 2018) have been 50% sold, with prices within expectation and profits that will be progressively recognized in the next 3 years.{loadposition advert1}

Some sum of parts analyses have even valued KSH's RNAV (revalued net asset value) at exceeding $1.20 per share, while a broker has placed a $0.81 target price on KSH.

3. Partnerships and hotels portfolio

KSH (and several other mid-sized construction/property companies in Singapore) have adopted a strategy that appears to have worked very well. Rather than going alone in making land bids, they have consolidated their financial resources in forming joint ventures to take on larger projects. This not just has the effect of spreading risks among the partners, but also means that the JV partners are less likely to overbid for land prices. Further, such joint bids have maintained a stream of construction project revenue that would be kept within the partnering companies (Riverside Residences being one such example, in which KSH is both the developing partner and contractor).

KSH’s strategy extends to the expansion of its overseas footprint. KSH has for years been active in the China property market. It has recently partnered with home-grown companies Heeton and Lian Beng in its forays into the Australia property and Japan/UK hospitality markets. While KSH typically has less than 30% stakes in such projects, this represents a prudent move which spreads risk across the JV partners.

Incidentally, this strategy is the source of KSH’s Gaobeidian project which was the fillip for KSH’s share price a year before. Furthermore, a recent corporate presentation by KSH presents a good picture of its part-owned hotel portfolio. While these are mostly budget to mid-tier hotels, there does appear to be a possibility for these properties to be incorporated into a Reit or divested at some stage.

Project Name	Location	Status
LUMA Concept Hotel	Glenthorne Road, London, England, UK	
IBIS Gloucester Hotel	Gloucester, Gloucestershire, England, UK	
IBIS Bradford Hotel	Bradford, West Yorkshire, England, UK	
Holiday Inn Express Manchester City Centre	Manchester City, England, UK	In Ope
Hotel Indigo Glasgow	Glasgow, Scotland, UK	
Smile Hotel Asakusa	Tokyo, Japan	
Super Hotel Sapporo	Chuo, Hokkaido, Japan	
Hampton by Hilton	Leeds, England, UK	
Day Inns Liverpool	Liverpool, England, UK	In Prog
Dry Bar Boutique Hotel	Manchester City, England, UK	
Wickham	Wickham, Fortitude Valley, Brisbane, Australia	

Source: KSH Holdings Corporate Presentation (Nov 2018)

Negative Factors

Notwithstanding the above positive factors, several risk factors exist, though these apply to construction companies generally.

1. Increasing operating costs

Like all other contractors in the construction industry, KSH is affected by the restriction in the number of foreign workers, increases in levies as well as rising dormitory costs. In 2017, BCA stated its aim to reduce the number of foreign construction works by up to 30% by 2020. This would translate into higher tender costs. For instance, according to data from BCA, the tender price index has increased by about 2.3% between 2017 and 2018Q3. While these cost increases would have been factored into the tender prices of recent projects, the risk is that input prices may further accelerate in the future.

2. Mid-term weakness in the Singapore property and construction markets

In July 2018, the Singapore government abruptly announced cooling measures for the Singapore property market, which dampened the share prices of construction and property companies, and (to an arguably lesser extent) the demand for residential purchases. While KSH has a strong balance sheet, its finances may deteriorate if the property market enters a sharp decline and/or if additional cooling measures are announced.{loadposition advert1}

3. Rising financing costs

While KSH is lowly geared, the majority (S$76m) of its debt are repayable within one year.

Should interest rates rise (which is likely), these interest-bearing liabilities may have to be financed at a much higher rate of interest. A 1% increase in the cost of financing would thus trim operating profit by about S$1.4m, not including the impact to associates. This would be an issue if the current cash reserves are not efficiently deployed.

Conclusion:

This analysis has refrained from factoring in any of the potential upside from KSH's Gaobeidian project, which would be a bonus if and when it materialises. Nonetheless, based on its track record, investment portfolio and latest order book, KSH looks attractive among its mid-cap construction/property peers. It is reminiscent of a previous undervalued stock (Hiap Hoe) that was previously featured here but which has since doubled. There's no reason why KSH cannot emulate this feat in the next 1-2 years and surpass its previous high of 91c.
BUY
.

Key recent rvents:

- Oct 2018: KSH and its partners delayed launching Phase 1 of the Gaobeidian project, citing poor market sentiments from the on-going trade war between the United States and the People's Republic of China
- Oct 2018: KSH and its partners acquired Hotel Indigo Glasgow in UK
- Aug 2018: KSH was awarded a S$266m contract to construct Riverside Residences
- Aug 2018: KSH and its partners acquired Smile Hotel Asakusa in Tokyo, Japan
- Jul 2018: KSH and its partners disposed of 7 strata office units in Prudential Tower
- Mar 2018: KSH and its partners acquired a land parcel in Geylang for residential development
- Apr 2017: China designated three counties in Hebei Province as the Xiongan New Area, which is adjacent to a large 533.3ha land parcel that KSH and its partners plan to build up to 50,000 residential units. KSH has a 22.5% stake in the Gaobeidian project.